No. 15318

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ROBERT F. ELLISON and
CLEO A. (ELLISON) WALKER,
Appellants,

v.

WILLIAM E. FRANK, United States District Director of Internal Revenue for the District of Washington and Territory of Alaska,
Appellee.

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON

HONORABLE GEORGE H. BOLDT, *Judge*

BRIEF FOR THE APPELLEE

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OPINION BELOW

The findings of fact and conclusions of law of the District Court (R. 20-26) are not reported.

JURISDICTION

This appeal involves federal income taxes for the tax year 1949. (R. 20.) On February 16, 1953, the

District Director of Internal Revenue for the District of Washington notified taxpayers of a proposed tax deficiency for 1949. (R. 4.) The District Director, in December, 1953, assessed a deficiency of $11,839.10 which, together with interest of $2,661.04, was paid by taxpayers on December 10, 1953. (R. 14-15.) On February 24, 1954, taxpayers filed a claim for refund. (R. 4.) After the expiration of six months, without acceptance or rejection of the claim by the District Director, suit was commenced by taxpayers on September 2, 1954, in the United States District Court for the Western District of Washington, Southern Division, for refund of the taxes allegedly wrongfully collected. (R. 4-5.) Jurisdiction of the District Court exists under 28 U.S.C. Section 1340. Judgment was entered in favor of the District Director on June 22, 1956. (R. 26-27.) Within sixty days, and on August 18, 1956, notice of appeal to this Court was timely filed by taxpayers. (R. 27-28.) This Court has jurisdiction under 28 U.S.C. Section 1291.

QUESTION PRESENTED

Whether the District Court erred in finding that taxpayer Robert F. Ellison did not own, or have a contract right to cut for sale or use in his business, certain tracts of standing timber so as to entitle him to capital gains treatment under Section 117(k) of

the Internal Revenue Code of 1939 on the income he earned therefrom in the course of his logging operations in 1949.

STATUTE AND RULE INVOLVED

The pertinent provisions of the statute and rule involved are set forth in the Appendix, *infra*.

STATEMENT

The facts of this case are taken from the District Court's findings of fact (R. 20-25), the transcript of testimony (R. 36-122), and exhibits introduced into evidence, some of which are printed in the record (R. 127-137), and the remainder of which are before the court by stipulation (R. 139).

The taxpayers at all times material hereto were husband and wife residing in the State of Washington. As such they filed their joint income tax return for the year 1949 with the Collector of Internal Revenue for the District of Washington. (R. 20.) Taxpayer Cleo A. (Ellison) Walker is a party solely because of the joint return feature, and references hereinafter to "taxpayer" are applicable only to Robert F. Ellison.

On his 1949 tax return Ellison reported the profit of $50,380.06 from timber operations as capital gains

on the theory that he owned and sold certain timber (described in Exhibits 2 and 3) within the meaning of Section 117(k) of the Internal Revenue Code of 1939. (R. 13, 15-16.) The Commissioner disallowed the capital gains treatment on the ground that taxpayer did not own the timber or have the right to cut it for sale or use in his business within the meaning of Section 117(k). (R. 16-17.) Treating the profit as ordinary income, the Commissioner assessed a deficiency in income tax of $11,839.10, which, together with interest of $2,661.04, was paid by taxpayer. (R. 14-15.) A claim for refund was filed, and more than six months having elapsed, taxpayer brought suit for refund. (R. 3-5.) The following facts were elicited at the trial:

In 1947 the United States, through the Forest Service of the Department of Agriculture, owned the fee to certain timber lands on the Green Forks River in the State of Washington. The Forest Service was then in the process of offering to sell the timber on said tract to the public under a pay-as-cut contract. (R. 21.)

Theodore Franklin Wall was employed by the Northwest Door Company (hereinafter called Northwest Door) in January, 1947, to acquire timber for Northwest Door, and to operate the Wall Boom (a distribution and storage point for the local logging indus-

try) which he had previously owned and which he sold to Northwest Door in 1946. (R. 79-81, 86.) Prior to Wall's employment with Northwest Door he had investigated the Green Forks area from the viewpoint of his own lumber business. (R. 85-86.) Taxpayer, a logger, accompanied Wall on at least two trips to see if logging operations could be conducted profitably (R. 82-83), but it is not clear whether the trips were before or after Wall was employed by Northwest Door (Compare R. 82-83 with R. 85).

As part of his duty of acquiring timber for Northwest Door, Wall investigated the Green Forks area as one of his first projects and recommended it to Northwest Door. (R. 82, 86.) Wall testified that Ellison was looking for a logging operation, that they discussed Ellison's acquiring the timber and logging it and decided that the operation was too big for Ellison. He would have to have financing to log the area. (R. 82-83.) Wall stated that he knew Ellison to be in the logging business. (R. 86.) In defining what a logger does, Wall conceded that "There are about as many different kinds of deals for logging as there are deals," and that "the logger is the fellow who in one manner or another, on one kind of a deal or another, brings the logs out." (R. 87-88.)

The Forest Service awarded portions of the Green Forks timber, and the contract right to cut the timber, to Northwest Door by contract Form 202, executed September 4, 1947. (Ex. 2.) This contract (hereinafter sometimes called the timber contract) by its terms provided that Northwest Door would purchase, cut and pay for the timber. (R. 22.) No timber was to be cut until paid for, and title to the timber remained in the United States until it had been paid for, felled and scaled, measured, or counted. (Ex. 2, Secs. 6, 11.) Thereafter title passed to Northwest Door which was financially liable to the United States for performance of the contract. (R. 22.) The purchase price for stumpage varied according to the types of timber. (Ex. 2, Sec. 2.)

Northwest Door agreed to have at least twelve men and supervisory personnel available to the Forest Officer in charge for the burning of slash[1] at the direction of such officer. (Ex. 2, Sec. 15.) In addition, many other safeguards were inserted in the contract for the protection of the National Forest, which by their nature were to be regulated and supervised by the Forest Officer in charge by direct contact with

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[1] Slash, as used in the contract, was defined as "all debris resulting from logging operations or from construction of roads or other improvements." (Ex. 2, Sec. 15b.)

Northwest Door's representative at the site of the logging operations. (See Ex. 2, Secs. 15a, 17, 18, 19, 20, 24, 27.) The contract expressly specified that Northwest Door "shall have at the main camp * * * a representative who shall be authorized to receive on behalf of the purchaser, any or all notices and instructions in regard to work under this agreement given by the Forest Officer in charge, and to take such action thereon as is required by the terms of this agreement." (Ex. 2, Sec. 35.)

It was also provided that the contract could not be transferred or assigned unless the transferee or assignee was acceptable to the United States and unless the transfer or assignment was approved in writing by the appropriate Forest Officer. (Ex. 2, Sec. 33.) And it was agreed that "The conditions of the sale are completely set forth in this agreement, and none of its terms can be varied or modified except in writing by the" appropriate Forest Officer. (Ex. 2, Sec. 41.)

Unless changed in writing by the Regional Forester, at least 10,000,000 feet B.M. was to be cut prior to December 31, 1948, and at least 20,000,000 feet B.M. prior to December 31, 1949. (Ex. 2, Sec. 3.) By letter dated December 23, 1948, to "Northwest Door Company," the Regional Forester approved a reduction of the volume required to be cut prior to December

31, 1948, from 10,000,000 to 4,000,000 feet B.M. (See letter attached to Ex. 2.)

An additional application for modification of the September 4, 1947, contract was submitted by "Northwest Door Company" on February 2, 1950, and after consent of the Aetna Casualty & Surety Company, which had undertaken the original guarantee of performance of Northwest Door (see Bond dated September 4, 1947, attached to Ex. 2), the application was approved by the Acting Regional Forester on February 17, 1950. (See Application for Modification of Agreement, and Consent of Surety, attached to Ex. 2.)

The record shows that Northwest Door corresponded with the Forest Service throughout the duration of the contract as the purchaser and owner of the Green Forks timber. (See Ex. A.) The records of the Timber Management Office of the Forest Service indicate that Northwest Door was the owner and holder of the Green Forks timber contract, and that there was no recorded assignment of any kind of that right. Ellison is not mentioned in those records in any way as having any right or interest in the timber contract. (R. 120-121.)

Northwest Door was in the business of manufacturing plywood, fir plywood, and fir doors. In 1947

most of its logs were procured in the open market. (R. 37.) Mr. Tenzler, the President of Northwest Door from 1947 to the time of this action, testified that Northwest Door's object in entering into the contract with the Forest Service was to assure itself of a supply of logs for use in the business. (R. 46.) When asked whether any other person, firm or corporation other than Northwest Door owned any interest in the Green Forks timber, he answered that the Vancouver Plywood Company owned an interest.[2] (R. 44.)

Northwest Door was not interested in making a profit from the logging operations. (R. 22.) A contract (hereinafter sometimes called the logging contract) was entered into with Ellison on December 9, 1947, in which he was designated as the "Logger". (Ex. 3, R. 127-133.) Northwest Door agreed to pay him, "for his services in logging and delivering said timber," the Columbia River market price for the logs as determined on the day of scaling, less the amount

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[2] At one point Vancouver Plywood Company was a party to the transaction (R. 47, 56) and appears as one of the parties of the first part in the contract entered into with Ellison as party of the second part. (See Ex. 3, R. 127-128.) It was stipulated, however, that Vancouver Plywood Company withdrew before any harvesting of timber. (R. 65-66.) For purposes of this appeal Vancouver Plywood's participation is immaterial and may be disregarded. (See footnote in taxpayer's brief, p. 14.)

which Northwest Door was required to pay the Forest Service as stumpage and other costs as might be imposed on Northwest Door under the timber contract with the Forest Service. (Ex. 3, Sec. 6, R. 130.)

By the express terms of the logging contract it was agreed that the logs, timber, and forest products shall remain the property of Northwest Door, and that Ellison "shall not have any right, title or interest therein other than the right to receive his compensation herein agreed to be paid." (Ex. 3, Sec. 5, R. 130.)

Ellison agreed to cut, fall, buck, yard, load and transport to navigable water at his expense all the timber described in the Green Forks timber contract, and at his own expense to construct and maintain all roads necessary for the removal of the timber. (Ex. 3, Secs. 1, 2, 3, R. 128-129.) He agreed to perform in accordance with the terms, conditions and specifications set out in the Green Forks timber contract and under the Direction of the Supervisor of Forest Service, and undertook Northwest Door's obligations in this respect, agreeing to perform "said logging services" in a good and workmanlike manner, and to pay all industrial insurance premiums and other taxes or assessments levied by any government. (Ex. 3, Secs. 3, 4, R. 129-130.) The cost of the surety bond was charged to Ellison. (R. 70.)

It was further agreed that Northwest Door would advance reasonable sums of money to Ellison for road construction, that the amount so advanced would be repaid by Ellison, and that Northwest Door might recoup such advances by regularly deducting amounts from the payments due Ellison under the contract. (Ex. 3, Secs. 8, R. 131-132.)

The logging contract between Northwest Door and Ellison was drafted by Edgar N. Eisenhower who was a director, secretary, and counsel for Northwest Door. (R. 48, 56.) Mr. Eisenhower testified that Northwest Door was interested in having the logs in the Green Forks area for its plywood plant. (R. 52.) Eisenhower stated that a discussion was held "to determine how much money was going to be required to build his roads and other things" and how Northwest Door was to be secured in its two primary objectives, first, the return of its money, and secondly, the acquisition of the logs. (R. 52.) At another point Eisenhower repeated that "I had instructions from our conference to draft such instrument as I thought would safeguard Northwest Door in the advances which it was making to Mr. Ellison, and secondly, to see that Mr. Ellison delivered to Northwest Door the logs which Northwest Door wanted to use in its plywood plant." (R. 56.)

Mr. Eisenhower stated that he discussed with Mr. Tenzler on more than one occasion the objectives to be reached in drafting the contract. In answer to the question whether he incorporated into the contract the objectives which he and Mr. Tenzler intended to accomplish (R. 58-60), he answered (R. 60):

> A. * * * I think I did; I think I did. It was carried out.
>
> Q. And you chose language which you considered to be appropriate for your objective, isn't that true?
>
> A. Certainly, those are my words.

Mr. Eisenhower testified further that he explored every possibility for securing the advances which Northwest Door was going to extend to Ellison, including taking a mortgage on Ellison's equipment. He determined that there was not enough security to justify a mortgage, and he finally decided on the contract actually used. (R. 61.)

Under the terms of the logging contract $100,000 was advanced to Ellison; $50,000 on March 16, 1948, and $50,000 on August 2, 1948. (R. 70.) This money was advanced for road building, to meet bills, to buy an occasional piece of equipment, to pay for a security bond, and for certain incidental expenses. (R. 90.) The money was repaid according to the formula established in the logging contract, *i.e.*, Northwest Door

deducted amounts from the remittances to Ellison sufficient to recoup the advances. (R. 70.) Remittances to Ellison were charged to Northwest Door's log purchase account. (R. 70.)

There is no evidence that the amounts Northwest Door had to pay for the timber for stumpage in advance of cutting were considered by the parties as a loan to Ellison, nor is there any evidence that he was obligated to repay such amounts irrespective of future events. When asked whether he put any money into the operation in addition to the $100,000 borrowed from Northwest Door, Ellison answered that he put in an additional $75,000, some of which was his own, the rest of which he was able to raise elsewhere. (R. 110.) He did not state that he considered the amount paid by Northwest Door for stumpage as an advance to him or as part of his investment.

Roy L. Ausserer, the manager of Northwest Door's log and lumber department, testified that Northwest Door owned stands of timber other than the Green Forks timber. (R. 73.) He stated that there were many ways of financing loggers, that Northwest Door sometimes owned the timber outright and paid the logger "a service charge" of a flat sum for bringing the logs out regardless of market fluctuation. (R. 74, 77.)

With respect to the timber contract, Mr. Ausserer, on October 18, 1951, wrote the Forest Service on Northwest Door's letterhead. He referred therein to Ellison as the "contract logger" for Northwest Door. (R. 103; Ex. A.) Mr. Ellison defined "contract logging" as removing someone else's logs from the woods for a certain price. (R. 105.)

The District Court found (R. 23) that the logging contract—

> was drafted after a full exploration of the situation by all concerned, and reflected the intentions of the parties precisely. Its provisions are clear and unambiguous. If the contract be subject to parol construction, then the evidence fully shows that the contract meant what it said.

The court, therefore, held that (R. 23-24, 25):

> Ellison had no right, title or interest in the timber at any time. He was to perform the service of logging the timber for Northwest Door Company and was to be paid for his services only. * * *
>
> * * * *
>
> * * * The Commissioner correctly determined that the gain from Ellison's logging operations was taxable to the taxpayers as ordinary income. * * *

SUMMARY OF ARGUMENT

Whether the taxpayer is entitled under Section 117(k) to capital gains treatment on the profits from

his logging operations in 1949 depends on whether he was the owner of the Green Forks timber. This is primarily a question of fact and the District Court's finding that taxpayer "had no right, title or interest in the timber at any time" should be affirmed unless "clearly erroneous."

There can be no question, in fact taxpayer concedes, that by the express and unambiguous terms of the logging contract he was to be paid for his "services," and ownership of the timber was to remain at all times with Northwest Door. As in *Carlen* v. *Commissioner*, 220 F. 2d 338 (C.A. 9th), the fact that the value of his services was measured by the market price, less stumpage, of the logs did not serve to locate ownership of the timber in taxpayer; Northwest Door agreed to this measure of services since it was not itself interested in a profit on the logging operations, but was concerned only with having a supply of logs.

It may be assumed that equitable ownership will satisfy Section 117(k), for the record shows that taxpayer held neither legal nor equitable title. While it may be that parol evidence was admissible in an attempt to impeach the clear meaning of the logging contract, the burden was on taxpayer to prove beyond question his claim that the contract was intended to place mere legal title in Northwest Door as a security device,

while real equitable ownership passed to him. Far from contradicting the terms of the logging contract, the parol evidence is entirely consistent with it and shows conclusively that the contract accurately described Northwest Door as the "owner" of the timber, and taxpayer as the "logger", for which he was "compensated" for his "services." The evidence more than substantiates the finding of the District Court, made after a full consideration of the parol evidence, that taxpayer held no right, title or interest in the timber at any time.

ARGUMENT

THE TAXPAYER WAS NOT ENTITLED TO THE CAPITAL GAINS BENEFITS OF SECTION 117(k) OF THE CODE SINCE HE NEITHER OWNED THE GREEN FORKS TIMBER NOR HAD THE CONTRACT RIGHT TO CUT IT FOR SALE OR FOR USE IN HIS TRADE OR BUSINESS

Under Section 117(j)(1) of the Internal Revenue Code of 1939[3] (Appendix, *infra*) the term "property used in the trade or business" (afforded capital gains treatment under Section 117(j)(2) of the Code) includes "timber with respect to which subsection (k)(1)

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[3] All references herein to the Code are to the Internal Revenue Code of 1939.

or (2) is applicable." The ultimate question in this case is whether the taxpayer is entitled to the benefits of the capital gains provisions of Section 117(k) of the Code (Appendix, *infra*), or whether his income in 1949 from the Green Forks logging operation is taxable as ordinary income under Code Section 22(a).

Section 117(k)(1) permits a taxpayer to elect on his return to have the cutting of timber for sale or for use in his business considered as a sale or exchange for capital gains purposes. The taxpayer must be one "who owns, or has a contract right to cut" the timber. If he has owned the timber or has held the contract right for the requisite period (six months prior to the beginning of the taxable year), gain is then recognized "in an amount equal to the difference between the adjusted basis for depletion of such timber in the hands of the taxpayer and the fair market value of such timber."

While the expression "contract right to cut" is not defined in the Code, it is perfectly clear from the language used in Section 117(k)(1) in its entirety that the taxpayer who desires to make the election under the statute must have a proprietary interest in the timber other than the mere interest of a contractor for compensation for work or services performed. It seems inescapable from the choice of the words "for sale or

for use in the taxpayer's trade or business" that the statute contemplates that the taxpayer must have such an interest in the timber as would enable him to exercise free disposition of it. It was so held by this Court in *Carlen* v. *Commissioner*, 220 F. 2d 338. And taxpayer concedes that he must show that he held a proprietary interest, *i.e.*, that he owned the timber. (Br. 34-35.)

Subsection (2) of Section 117(k) likewise requires for its applicability that the taxpayer be the owner of the timber.

This case, therefore, will turn on the resolution of the question whether taxpayer was the owner of the Green Forks timber. This is primarily a question of fact, and the District Court's finding (R. 23) that "Ellison had no right, title or interest in the timber at any time" should be affirmed unless "clearly erroneous." Federal Rules of Civil Procedure, Rule 52 (Appendix, *infra*); *United States* v. *Yellow Cab Co.*, 338 U.S. 338; *United States* v. *Real Estate Boards*, 339 U.S. 485.

Northwest Door was in the business of manufacturing plywood, fir plywood, and fir doors. (R. 37.) It entered into a contract with the Forest Service of the United States Department of Agriculture, dated September 4, 1947, whereby it purchased from the

United States certain tracts of standing timber in the Green Forks area. (Ex. 2.) Under this "Timber Sale Agreement" title remained in the Forest Service until the timber had been paid for, felled and scaled, measured or counted. (Ex. 2, Secs. 6, 11.) Thereafter, by the terms of the agreement, title passed to Northwest Door. (R. 22.) The primary reason why Northwest Door entered into this contract was to assure itself a supply of logs for use in its business. (R. 46, 52, 56.)

On December 9, 1947, Northwest Door entered into a contract with taxpayer Ellison, concerning the Green Forks timber, whereby the former was designated the "Owner" and the taxpayer was referred to as the "Logger." (Ex. 3, R. 127-133.) Taxpayer's duties under this logging contract were to cut, fall, buck, yard, load and transport to navigable water all the timber described in the Green Forks timber contract. (R. 128-129.) Northwest Door agreed to pay him, "for his services in logging and delivering said timber", the market price less the stumpage and other costs as imposed under the timber contract with the Forest Service. (R. 130.) The logging contract explicitly specified that the logs, timber, and forest products were to remain the property of Northwest Door, and that Ellison "shall not have any right, title or interest therein other than the right to receive his compensation" for his services. (R. 130.)

There can be no question but that the logging contract was designed to obtain taxpayer's services, and that under its terms taxpayer was either an employee or an independent contractor. While he was to be paid the prevailing market price, that did not locate ownership of the timber in him. As in *Carlen* v. *Commissioner*, *supra* (where the taxpayer was also paid the market price less stumpage), it was merely the contract measure of the value of his services. The market price was paid taxpayer since Northwest Door was not itself interested in a profit on the logging operations (R. 22), but was concerned only with having a supply of logs. (R. 46.)

Taxpayer concedes (Br. 32) that the logging contract standing alone, unimpeached, would preclude any claim on his part of ownership of the timber, and that the *Carlen* case would be controlling authority against his position. But he claims that the logging contract represents only the form of the transaction and does not reflect the intent of the parties thereto, and that he successfully showed by parol evidence that the real incidents of economic or equitable ownership were in himself. See *Carlen* v. *Commissioner*, *supra*; *Wilson* v. *Commissioner*, 26 T.C. No. 56.

While it would appear that a taxpayer might under certain circumstances impeach a contract, to

which he himself was a party, as not representing the intent of the parties[4], it has been recognized that the effect of such a rule places the Government at a decidedly unfair disadvantage. Thus in the family partnership cases the taxpayer may not elect to treat the partnership as sham for tax purposes. The election to either sustain or disregard the effect of a sham partnership is with the Commissioner to exercise as best serves the purposes of the taxing statute. *Higgins* v. *Smith*, 308 U.S. 473, 477; *Maletis* v. *United States*, 200 F. 2d 97 (C.A. 9th). The rationale of this rule was persuasively expressed by this Court in *Maletis* v. *United States*, *supra*, as follows (p. 98):

> The Bureau of Internal Revenue, with the tremendous load it carries, must necessarily rely in the vast majority of cases on what the taxpayer asserts to be fact. The burden is on the taxpayer to see to it that the form of business he has created for tax purposes, and has asserted in his returns to be valid, is in fact not a sham or unreal. *If in fact it is unreal, then it is not he but the Commissioner who should have the sole power to sustain or disregard the effect of the fiction since otherwise the opportunities for manipulation of taxes are practically unchecked.* That which best serves the purpose of the tax statute should govern in this field and not the yearly exigencies of

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[4] *Helvering* v. *Larazus & Co.*, 308 U.S. 252; *Landa* v. *Commissioner*, 206 F. 2d 431 (C.A. D.C.). See *Hatch's Estate* v. *Commissioner*, 198 F. 2d 26 (C.A. 9th).

this taxpayer. The general rule has often been stated:

> "The taxpayer may not escape the tax consequences of a business arrangement which he made upon the asserted ground that the arrangement was fictional." *Love* v. *United States*, 119 Ct. Cl. 384, 96 F. Supp. 919, 921.

While it may possibly be that taxpayer is not estopped from attacking the logging contract as misrepresentative of the intent of the parties[5], the burden of overturning the clear and unambiguous terms of the contract should at least be very heavy. Taxpayer will certainly have to prove beyond question his claim that the contract was intended as something entirely different from what it purports to be. *Maletis* v. *United States*, *supra*. Compare *Hatch's Estate* v. *Commissioner*, 198 F. 2d 26 (C.A. 9th).

Taxpayer contends that either the District Court refused to consider the parol evidence or was unduly influenced by the formal terms of the contract. (Br. 10, 20.) But the record shows that the District Court found, after a full trial, during which all offered evidence was admitted and considered, that "If the [logging] contract be subject to parol construction, then the evidence fully shows that the contract meant what it said." (R. 23.) And we will show that the parol

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[5] See footnote 4, *supra*.

evidence, far from contradicting the logging contract, shows conclusively that title, whether legal or equitable, never was in taxpayer.

Taxpayer's main thesis is that the logging contract was a security device. (Br. 3-4, 18.) But he has completely misconstrued what it was that Northwest Door was securing. Apparently it is customary for the logger to bear the necessary expenses incident to cutting, felling, loading and transporting the logs to their destination. See *Carlen* v. *Commissioner*, *supra*. He must also furnish the equipment. After inspecting the area, taxpayer realized that he did not have sufficient capital to finance the expenses which would fall on him as logger. (R. 82-83.) It was therefore agreed in the logging contract that Northwest Door would advance the money required *for the construction of the road*. (R. 131-132.) During 1948, $100,000 was loaned taxpayer for road building and other expenses of the operation. (R. 70, 90.) It was the return of this money that Northwest Door was concerned about and which the contract was designed to secure.

The contract was drafted by Edgar N. Eisenhower, counsel for Northwest Door. (R. 48, 56.) He concurred with Mr. Tenzler, president of Northwest Door, that their primary objective in purchasing the timber from the Forest Service was to be assured a

supply of logs for use in the business. (R. 46, 52, 56.) Eisenhower testified that since it would be necessary to loan taxpayer money to build roads and pay certain other expenses, the transaction would have to be handled so as to secure Northwest Door for the return of the loans. (R. 52, 56.) He explored every possibility for securing these loans, including the taking of a mortgage on taxpayer's equipment. He determined that there was not sufficient security to justify a mortgage, and finally decided on the contract actually used. (R. 61.)

Counsel for taxpayer admits that the contract was to secure loans only in the amount of $100,000 (Br. 8-9), and taxpayer testified to the same effect (R. 110). Concededly this $100,000 was loaned him for road construction, not as an advance on the purchase price of the timber. It must be kept in mind that taxpayer's case rests on his contention that equitable title was transferred to him, and that the logging contract was designed to keep legal title in Northwest Door to secure the payment of the *purchase price of the timber.* If taxpayer purchased the timber from Northwest Door, a necessary legal consequence would be legal liability on his part to reimburse Northwest Door for the purchase price. In this respect it is fatal to taxpayer's position that there is no evidence in the contract or anywhere else that he borrowed money

from or was obligated to reimburse Northwest Door for the purchase price of the timber. While the market price which Northwest Door was to pay taxpayer was to be reduced by the stumpage (the same as in the *Carlen* case), taxpayer had no personal obligation to reimburse Northwest Door.

Consider the case if a load of logs already paid for by Northwest Door[6] was never delivered by taxpayer. He would not be entitled to his pay for services, of course, but, if he were the purchaser and owner of the timber he would nevertheless be obligated to pay Northwest Door the purchase price. Since taxpayer had no legal obligation to reimburse Northwest Door for the purchase price, he could not qualify as a purchaser, and the logging contract could not have been intended as security for the payment of such price.

The contract authorized Northwest Door to recoup the advances for road construction by regularly deducting amounts from the payments due taxpayer. This is the only security feature of the entire contract and is obviously what was referred to by Tenzler and

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[6] Contrary to taxpayer's assertion (Br. 16), the Forest Service did not await delivery of logs from taxpayer to Northwest Door before it was paid. The timber contract provided that Northwest Door must pay the purchase price before the timber was cut (Ex. 2, Sec. 11.)

Eisenhower when they spoke of the contract as securing Northwest Door's interest. Eisenhower testified (R. 56) that—

> I had instructions from our conference to draft such instrument as I thought would safeguard Northwest Door in the advances which it was making to Mr. Ellison, and secondly, to see that Mr. Ellison delivered to Northwest Door the logs which Northwest Door wanted to use in its plywood plant.

Obviously, the advances Eisenhower spoke of were the advances amounting to $100,000 for road construction, for these were the only advances extended taxpayer and the only advances for which he was legally liable.

Eisenhower was asked whether he incorporated into the contract the objectives which he and Tenzler intended to accomplish. (R. 58-60.) He answered (R. 60):

> A. I think I did; I think I did. It was carried out.
>
> Q. And you chose language which you considered to be appropriate for your objective, isn't that true?
>
> A. Certainly those are my words.

This testimony is clear. The contract means what it says. We will concede that the contract served as a security device as well as a contract for services. However, it was designed to secure Northwest Door, not for the purchase price of the timber, but only for the

repayment of the loans amounting to $100,000, which taxpayer *was* legally obligated to repay. (R. 131.) The contract, even with the parol explanation, is no proof that equitable title was in the taxpayer. To the contrary, Tenzler testified that aside from Northwest Door and Vancouver Plywood Company[7] no other person, firm or corporation owned any interest in the Green Forks timber. (R. 44.) Far from contradicting the contract, the parol evidence is entirely consistent with it.

The fact that Northwest Door was primarily concerned with obtaining an adequate supply of logs is inconsistent with a purpose on its part to have transferred ownership to taxpayer. Otherwise in the event of a dispute, taxpayer might have withheld the very supply of logs which Northwest Door needed. On the other hand, by retaining full ownership, Northwest Door was assured of having the logs even if taxpayer breached the contract.

And from taxpayer's viewpoint, how was he ever to prove his claim of ownership in event of a dispute? Under Washington law a conveyance of standing timber is within the statute of frauds. *Groeneveld* v. *Dean*, 40 Wn. 2d 109, 241 P. 2d 443; *Elmonte Inv. Co.* v. *Schafer Bros. Logging Co.*, 192 Wash. 1, 72 P. 2d

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[7] See footnote 2, *supra.*

311; *France* v. *Deep River Logging Co.*, 79 Wash. 336, 140 Pac. 361. Furthermore, the timber contract specified that no transfer or assignment would be valid unless the transferee or assignee was acceptable to the United States and unless the transfer or assignment was approved in writing by the appropriate Forest Office. (Ex. 2, Sec. 33.) Taxpayer concedes, as he must, that there was no written transfer or assignment, although he seems to suggest that the logging contract may be considered a conditional sale contract or trust receipt. (Br. 29.) But clearly the logging contract does not purport to be any such thing. Thus by way of comparison, *Wilson* v. *Commissioner*, 26 T.C. No. 56, is no support for taxpayer. There the Tax Court held that the taxpayers, as conditional vendees, were the owners for purposes of Section 117(k)(2). But the instrument which transferred ownership to them was intended as and actually was on its face a conditional sale contract. Here, by contrast, there is no document in existence which in fact ever transferred title, or which was ever intended to transfer title, whether legal or equitable, to taxpayer.

As a reasonably prudent business man who was an experienced logger, it would seem that taxpayer would have insisted on some sort of written evidence of his ownership if it were really intended that ownership be transferred to him. There is no suggestion

of any reason for disguising the nature of the transaction. A conditional sale contract, or a conveyance with a mortgage back[8], could have been utilized with complete protection for Northwest Door (except that of assuring itself a supply of logs which could only be attained by retention of complete ownership), and which would have given taxpayer proof of ownership in the event of a dispute. It is unbelievable that taxpayer would not have insisted on written title if, as he claims, all Northwest Door wanted was security.

Taxpayer relies on the following excerpt from a letter, which Northwest Door was contemplating writing to Vancouver Plywood Company (Ex. 7, R. 135-137), as showing ownership of the timber in himself (Br. 16):

> As you know, on the Green Forks timber neither of us will make any gain or loss on the logs, as the contract has been turned over to Ellison. All we will receive are logs at current market prices.

All that Mr. Raknes meant was that inasmuch as taxpayer was receiving market price (less stumpage) for his services, Northwest Door would not make a profit

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[8] Eisenhower considered taking a mortgage, not on the timber as taxpayer suggests, but only on taxpayer's equipment. (R. 61.) The fact that Eisenhower never considered a mortgage on the timber itself supports our position very strongly that ownership of the timber remained with Northwest Door.

on the logging operations. But Northwest Door was not interested in a profit from the logging operations. Being concerned only with having a supply of logs, Northwest Door was content to pay taxpayer the market price, less stumpage, for his services.

The very exhibit from which taxpayer quotes (Ex. 7, R. 135-137) shows that ownership of the timber was in Northwest Door. The subject of the exhibit was a possible trade with Vancouver Plywood. The proposed letter indicates that Northwest Door was considering transferring the Green Forks tracts to Vancouver Plywood. Far from indicating that taxpayer owned the tract, it shows conclusively that as of August 4, 1948, Northwest Door considered itself the owner.

There is further evidence that Northwest Door continued to deal with the Green Forks timber as owner. The timber contract was twice modified by negotiations between Northwest Door and the Forest Service. By letter dated December 23, 1948, to Northwest Door Company, the Regional Forester approved a reduction of the volume required to be cut prior to December 31, 1948, from 10,000,000 to 4,000,000 feet B.M. (see letter attached to Ex. 2.) An additional application for modification of the timber contract was submitted by Northwest Door on February 2,

1950, and after consent of the surety company, which had undertaken the original guarantee of performance by Northwest Door (see bond dated September 4, 1947, attached to Ex. 2), the application was approved by the Acting Regional Forester on February 17, 1950. (See Application for Modification of Agreement, and Consent of Surety, attached to Ex. 2.) There is no mention of taxpayer in either of these modifications.

The record shows that Northwest Door corresponded with the Forest Service throughout the duration of the contract as the purchaser and owner of the Green Forks timber. (R. 102-103, Ex. A.) And the records of the Timber Management Office of the Forest Service indicate that Northwest Door was the owner and holder of the Green Forks timber contract, and that there was no recorded assignment of any kind of that right. Taxpayer is not mentioned in those records as having any right or interest in the timber contract. (R. 120-121.)

The fact that Northwest Door continuously dealt with the Forest Service as though it was the owner, and the fact that taxpayer never asserted any right consistent with a proprietary interest in himself, compels the conclusion that the logging contract accurately located legal as well as beneficial title in Northwest

Door. Compare *Hatch's Estate* v. *Commissioner*, 198 F. 2d 26 (C.A. 9th).

Taxpayer can derive no consolation from the definition of "logger" as found in the record of this case. He states that a logger is a man who goes into the woods, acquires timber, puts the logs on the market and sells them. (Br. 11.) It would appear from the *Carlen* case that the logger does not acquire the timber, and the record here shows that the logger does not necessarily acquire the timber. (R. 87-88.) Even where the logger is financed, it is not unusual for the lumber company to retain ownership. (R. 74, 77.) Mr. Wall testified that there are many different kinds of logging deals, but that "the logger is the fellow who in one manner or another, on one kind of a deal or another, brings the logs out." (R. 87-88.) In a letter dated October 18, 1951, from Northwest Door to the Forest Service, taxpayer was referred to as "contract logger" for Northwest Door with respect to the Green Forks timber. (R. 103.) And taxpayer himself defined "contract logging" as removing *someone else's* logs from the woods. (R. 105.)

Taxpayer states that Northwest Door acquired its logs in 1947 either by purchases in the open market or by financing the loggers. (Br. 11.) This is an inaccurate statement. Northwest Door owned stands

of timber other than the Green Forks tract and paid loggers for their services for logging or bringing the timber out. (R. 73, 74, 77.) In any event, there is nothing inconsistent with financing the logger and retaining ownership, as this case well demonstrates.

Taxpayer points out (Br. 14-15) that with regard to many of the practical matters relating to performance of the contract, such as provisions for cleanup and slash disposal, he dealt directly with the Forest Service in settling any problems that arose. But this was to be expected. Northwest Door agreed to have at least twelve men and supervisory personnel available for the burning of slash under the direction of the Forest Officer in charge. (Ex. 2, Sec. 15.) In addition, the contract is replete with provisions to safeguard the forest, which were to be regulated and supervised by the Forest Officer by direct contact with Northwest Door's representative at the logging site. (See Ex. 2, Secs. 15a, 17, 18, 19, 20, 24, 27.) The timber contract expressly specified that Northwest Door "shall have at the main camp * * * a representative who shall be authorized to receive * * * any or all notices and instructions in regard to work under this agreement given by the Forest Officer in charge." (Ex. 2, Sec. 25.) The taxpayer was Northwest Door's representative with regard to problems arising in the woods which were subject to regulation and super-

vision by the Forest Officer in charge. Any exchange of timber that may have been negotiated by taxpayer was done so in his capacity as representative for Northwest Door.

It is likewise of no moment that taxpayer may have dealt directly with the Forest Service with regard to making changes in the road (Br. 15), for under the logging contract he was to bear the expenses of constructing and maintaining all roads necessary for the removal of the timber (R. 128-129).

Taxpayer also points out that Northwest Door charged the payments made him to its log purchase account. The same was true in the *Carlen* case, and the Tax Court's handling of the matter, which was affirmed by this Court, may be deemed applicable here. Thus the charge to log purchases should be assumed "to have been for bookkeeping purposes and did not purport to evidence a sale by" the taxpayer to Northwest Door. *Carlen* v. *Commissioner*, 20 T.C. 573, 578.

In summary it may be said that Northwest Door was primarily concerned with assuring itself a supply of logs. After full discussion it was decided to purchase the timber and pay taxpayer to log it. He needed loans of money to finance the expenses imposed on him under the contract, namely, the cutting of the roads

and certain other expenses. This raised the problem of providing security for the repayment of the loans, and it is in this regard that Tenzler and Eisenhower spoke of the logging contract as serving as security.

It is clear that the logging contract accurately described the legal relationship of the parties to each other and the timber. Northwest Door was the "owner" of the timber; taxpayer was hired as the "logger" to cut the timber and haul the logs out, for which he was "compensated" for his "services." The parol testimony, as we have shown, is entirely consistent with the contract. There is no substance to taxpayer's claim of equitable ownership. The evidence more than substantiates the finding of the District Court (R. 23) that "Ellison had no right, title, or interest in the timber at any time." *Carlen* v. *Commissioner*, 220 F. 2d 338 (C.A. 9th), is controlling, and requires that taxpayer's profits be taxed as ordinary income.

CONCLUSION

For the reasons advanced above, the judgment of the District Court is correct and should be affirmed.

Respectfully submitted,

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APPENDIX

INTERNAL REVENUE CODE OF 1939:

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * *

(j) [as added by Sec. 151(b) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and amended by Sec. 127(b) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gains and Losses from Involuntary Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term "property used in the trade or business" * * * Such term also includes timber with respect to which subsection (k)(1) or (2) is applicable.

* * * *

(k) [as added by Sec. 127(a) of the Revenue Act of 1943, *supra*] *Gain or Loss Upon the Cutting of Timber.*—

(1) If the taxpayer so elects upon his return for a taxable year, the cutting of timber (for sale or for use in the taxpayer's trade or business) during such year by the taxpayer who owns, or has a contract right to cut, such timber (providing he has owned such timber or has held such contract right for a period of more than six months prior to the beginning of such year) shall be considered as a sale or exchange of such timber cut during such year. In case such election has been made, gain or loss to the taxpayer shall be recognized in an amount equal to the difference between the adjusted basis for depletion of such timber in the hands of the

taxpayer and the fair market value of such timber. Such fair market value shall be the fair market value as of the first day of the taxable year in which such timber is cut, and shall thereafter be considered as the cost of such cut timber to the taxpayer for all purposes for which such cost is a necessary factor. If a taxpayer makes an election under this paragraph such election shall apply with respect to all timber which is owned by the taxpayer or which the taxpayer has a contract right to cut and shall be binding upon the taxpayer for the taxable year for which the election is made and for all subsequent years, unless the Commissioner, on showing of undue hardship, permits the taxpayer to revoke his election; such revocation, however, shall preclude any further elections under this paragraph except with the consent of the Commissioner.

(2) In the case of the disposal of timber (held for more than six months prior to such disposal) by the owner thereof under any form or type of contract by virtue of which the owner retains an economic interest in such timber, the difference between the amount received for such timber and the adjusted depletion basis thereof shall be considered as though it were a gain or loss, as the case may be, upon the sale of such timber. * * *

(26 U.S.C. 1952 ed., Sec. 117.)

RULE 52 [as amended December 27, 1946]. FINDINGS BY THE COURT.

(a) *Effect.* In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment

* * *. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. * * *

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